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UNITED STATES SEED ACT ASSISTANCE STRATEGY UPDATE

FOR
LITHUANIA



1994-1996

Submitted by American Embassy Vilnius
Approved June 26, 1994

UNITED STATES SEED ACT
ASSISTANCE STRATEGY
FOR
LITHUANIA

UPDATE

Submitted by American Embassy Vilnius
May 24, 1994

LITHUANIA COUNTRY STRATEGY

I. OVERVIEW

Lithuania is one of 15 newly independent states which comprised the former Soviet Union. It was annexed into the Soviet Union and was more subsumed into the Soviet mode of operating than its Central and Eastern Europe neighbors, thereby presenting challenges somewhat different from those of CEE countries.

The U.S. is the largest bilateral donor in Lithuania and its activities are high profile and strongly supported and appreciated by the Government of Lithuania (GOL) and the emerging private sector. The U.S. has played a leadership role among the donors that has been aided by Lithuania's close ties to the U.S. and through the large community of Americans of Lithuanian heritage who support this effort.

Lithuania regained its independence in 1991. Since that time it has been engaged in an effort to transform its economy into a full-fledged market system. Parliamentary and Presidential elections were held in late 1992 and early 1993, and reforms have proceeded under the new government despite initial concerns regarding the political leaning of the elected party. An economic program to achieve macroeconomic balance and structural reform was launched in 1992, supported by two IMF stand-by arrangements and a World Bank import rehabilitation loan.

This strategy document identifies assistance needs and priorities of the Lithuanian economy and ways in which our limited resources can effect change. It concentrates on three priorities: (1) developing the private sector, with increasing emphasis on agriculture; (2) addressing the need for energy efficiency, safety of the Ignalina Nuclear Power Plant, and environmental concerns; and (3) strengthening democratic institutions, both governmental and non-governmental. The principal changes from the strategy of last year are increased emphasis on environment and the role of agriculture in economic transformation, and more coherence of the disparate efforts promoting the strengthening of democratic institutions through the Mission's new democracy strategy.

II. STATUS OF REFORMS

Although considerable progress was made towards monetary independence when Lithuania withdrew from the ruble zone in October of 1992, the intent to implement prudent monetary policy was clearly demonstrated on May 10, 1993 when the Central Bank of Lithuania first flexed its muscles by increasing reserve

requirements for commercial banks and taking other steps to introduce and maintain a sound national currency and reduce inflation. On April 1, 1994 the government began operating under a currency board. This decision is a result of the desire to further increase financial stability and encourage foreign investor confidence in Lithuania. Under a currency board -- in which the Litas is backed 100 percent by foreign reserves and gold -- it is expected that foreign investment will increase as foreign exchange risks fall and monetary stability increases.

Results in privatization have been mixed but mostly positive. It is estimated that 4,233 entities, or 54 percent of total enterprises, have had ownership transferred from the state to private hands. Still, several problems remain with privatization: given the speed of progress, it is unlikely that the GOL target for state property privatized by the first half of 1994 will be met; with current legislation, land reform is unlikely to be complete before the year 2000; in the absence of a well-functioning stock market, there is the less than optimal use of the one-time investment vouchers; privatization of nonagricultural land has not begun; and recently the law on privatization was amended to allow employees to acquire up to 50 percent of the shares in companies being privatized (up from 30 percent). A GOL decision in February, 1994 to cancel the hard currency privatization of a major hotel sent a negative signal to potential foreign investors. While many companies have been privatized through a transfer to employee ownership, badly needed investments in physical and human resources have not yet been made.

Former collective farms have been broken up into agricultural enterprises but finalizing the land privatization process in the agriculture sector is necessary for farmers to have full access to resources and to be able to make rational long term decisions. Land privatization directly affects investment in land-dependent activities such as agriculture, housing and forestry development, and without it investments to improve and expand production will be hindered. In spite of this, Lithuania now has 100,000 private farms. Also affecting agriculture is the availability of credit to farmers: without relying on subsidized credits that distort the allocation of resources, the GOL needs to expand credit to the sector at affordable interest rates.

Energy reforms include increasing the price of energy much closer to world market prices and improving nuclear power plant operations and regulation. A key environmental reform is the imminent creation of the Ministry of Environmental Protection.

The Lithuanian legal system is in a state of transition from the Soviet system to a democratic model. The current court system consists of a two-tier structure of district courts and a supreme court. Jury trials are not yet used in Lithuania. A law reforming much of the structure and procedures is scheduled to take effect by mid-1994 and would create two additional levels of

courts; the district court and an appeals court. The newly created constitutional court began its deliberations in September of 1993. The media is basically open and free but needs specific interventions to be strengthened.

III. ACHIEVEMENTS OF U.S. ASSISTANCE PROGRAM

In the financial sector, U.S. government assistance has had a substantial impact not only by assisting in such areas as tax administration, budget policy, bank training, and management, but also through the direct education of government officials in the mechanisms of a market economy. The recently enacted value added tax (VAT) was developed by a SEED funded advisor. A major success resulted from a four month series of daily meetings involving SEED funded advisors (Treasury, IESC) with the Central Bank President and his staff in 1993, resulting in monetary policy changes such as an increase in the reserve requirement that led to the smooth introduction of the national currency and a significant reduction in inflation. IESC activities have been heavily oriented toward banking to complement other financial sector interventions.

To promote the business sector, USAID contractors have assisted in the privatization of 11 large enterprises, including the Klaipeda Tobacco Company which has provided Lithuania's largest single foreign investment of \$40 million and the Vilnius Audejas textile factory, the third largest foreign investment of \$8 million. U.S. advisors in the legal sphere are promoting the adoption of commercial law reform that will enhance the environment for investment, both foreign and domestic. A Commercial Law Center has been established in Vilnius to serve as a training and resource base.

Agricultural reform has been enhanced through Volunteers for Overseas Cooperative Assistance (VOCA) to various areas within the agricultural sector, from cooperative development, farm building, agribusiness management and marketing. Results include business plan completion and U.S. style agricultural cooperative introduction. VOCA activities are being developed to promote rural banking development, and a major dairy production and cooperative initiative through Land O'Lakes has been proposed.

U.S. assistance to the energy sector has promoted energy efficiency through efforts at four large enterprises involving operational and maintenance changes and small equipment purchases which have led to dramatic energy savings. The lessons were shared at a Baltic-wide meeting in Kaunas. A regional approach to energy issues has also been promoted through support to the Baltic Regional Dispatch Center. The introduction of energy pricing models has promoted understanding of energy pricing methodologies. Recent assistance in prevention and management of accidents has helped management of the Ignalina Nuclear Power Plant deal with the possibilities of fire or other operational hazards. Other efforts include strengthening Lithuania's nuclear

regulatory capability.

Key progress in environmental protection involves programs of waste minimization and institutional strengthening. Through demonstration projects using monitoring equipment, the results of waste minimization are impressive. For example, emissions at the Kedainiai Chemical Plant, a major polluter, have been reduced by 50% since a World Environmental Center (WEC) emission control program began only one year ago. The results of this and three similar programs are now being disseminated through seminars. Institutional strengthening of the GOL's Environmental Protection Department (EPD) through EPA assistance has paved the way for the EPD to assume ministerial status and play a predominant role in addressing environmental issues.

To strengthen democratic institutions, USAID assistance has been used to provide legal analysis of draft legislation and assist in judicial reform and to promote judicial training, training of journalists, parliamentary training, and political party development. The SEED funded Library of Congress program has resulted in computerization of information systems of the Parliament through installation of hardware, software, and related training. A three day parliamentary training session was also conducted which helped newly elected parliamentarians of all parties address the issues involved in defining their proper role in a democratic society. The Mission's new democracy strategy (attached) will bring greater coherence to the many planned activities in this area.

IV. UPDATE OF STRATEGY PRIORITIES

Although a significantly higher level of resources could be utilized, this strategy assumes that the current level of assistance to Lithuania of approximately \$13 million annually in SEED funds will be maintained. As the Baltic Enterprise Fund begins operations, it will result initially in a net increase in total funding. The question of the phase down of assistance remains difficult since Lithuania's economy has only recently hit bottom after a severe fall and the new government has a short track record. Given that Lithuania is less industrialized than its Baltic and East European neighbors, dependent on a primitive, Soviet style agricultural sector, and has had less exposure to Western economic models and influences, USG assistance should play an important role in Lithuania's future for several years, probably through the remainder of the decade.

A. PRIVATE SECTOR DEVELOPMENT

1. Financial Sector Reform

Since 1991, Lithuania has worked to develop a banking system that can assist in the normal function of a market economy. The GOL has worked on privatizing state-owned banks and developing a framework for commercial bank activities. The three state banks

are partially privatized and audits by international companies are underway. Legislation to clarify and strengthen the role of the Central Bank and to expand the role of commercial banks is being developed. Other plans include reviewing the bank licensing system, strengthening bank supervision and bringing banking rules in line with international standards. With the currency board limiting the Central Bank's monetary policy activities, banking supervision activities currently underway have become a high priority.

Although a large informal financial sector operates in Lithuania, commercial banks will overtake the informal sector as confidence in the formal banking sector increases due to higher stability and increased services. In their expanded role, the commercial banks will need to move from their focus on short-term financing of trade and working capital to medium and long-term investment proposals. Banks will need to acquire skills to evaluate investment proposals and effectively manage loans.

Along with changes in the banking sector, the tax department in the Ministry of Finance continues to develop. It is implementing a value added tax (VAT) to replace a cumbersome excise tax, working on tax collector training, creating a Treasury function and furthering tax strategy development. As goals are achieved in the banking and tax sectors over the next 12-24 months, assistance to the financial sector will be winding down. USAID can then shift its resources to other areas within the developing private sector.

U.S. Assistance to the Financial Sector Will:

- * Strengthen the ability of the Central Bank to supervise and regulate commercial banks and provide stability to the banking system;
- * Facilitate the development and implementation of tax laws and other legal requirements necessary to strengthen the Lithuanian financial sector; and
- * Strengthen basic banking and technical skills.

2. Business Sector Promotion

The U.S. plays an important role in promoting the transformation of the Lithuanian business sector from one of state ownership and control to one based on private ownership. This role focuses on the development of an environment in which new private businesses can develop and grow, whether they originate from the privatization or break up of existing enterprises or through the start-up of new firms.

Although the transfer of enterprises to private hands has gone well, often very little has changed at many firms, partly due to the dearth of management talent at all sizes of enterprises.

Lithuania has been completely isolated from western business influences and continues to rely on management trained in Soviet methods. Thus, businesses continue to be ill-prepared to compete in a Western environment. U.S. assistance in training and educating entrepreneurs will have a lasting impact on the Lithuanian economy.

Legal and regulatory reform is critically needed in a number of areas for the development of a thriving business sector. The current environment in which businesses operate needs further improvement if business development is to be encouraged. Difficulties in registering companies and securing legal title to collateral pledged against a loan are only a couple examples of poorly functioning systems which act as a drag on private sector development and growth. Difficulties in the implementation of legislation providing for land restitution jeopardize development as well as discourage foreign investment. Though bankruptcy legislation has been adopted, the low number of bankruptcies, despite insolvency of many firms, indicates other factors are preventing bankruptcies from happening, and therefore hindering the efficient reallocation of limited resources.

U.S. Assistance to the Business Sector Will:

- Provide investment capital through the Baltic Enterprise Fund;
- Strengthen enterprises in areas such as accounting, finance, marketing, production, and management;
- Provide policy advice to the GOL on investment issues; and
- Provide policy advice to the GOL on legal issues affecting the development of the business environment.

3. Agricultural Reform

In 1991, the GOL began a program of privatization to restructure and transform the Soviet system to an open market economy. The rate of privatization has been slow and this can be expected to have a significant impact on the agriculture sector through an overall reduction in production. The sector is undergoing a restructuring process that, combined with the situation after 1991 and the ensuing transformation period, has created a set of constraints that inhibits the progress of the sector, including: 1) high costs of production due to inefficient management, outdated technology and inappropriate use of inputs, 2) an infrastructure and institutional system that is not able to address the current needs of the evolving private sector in such areas as technology transfer, credit, land title, modern business techniques and management, 3) low production levels even in areas where Lithuania has a relatively high comparative advantage such as dairy and meat enterprises, 4) a lack of knowledge and information regarding marketing, supply and demand data and the

lack of experience to use the information. Further affecting the sector is the general decrease in consumer purchasing power resulting from unemployment and inflation, the social costs of restructuring, and the lack of credit to farmers.

Agriculture in Lithuania can be an engine of growth to the economy of Lithuania. A restructured agricultural sector would prevent Lithuania from becoming dependent on its neighbors for agricultural imports it can produce as well or better at home and may in the future present opportunities for earning crucial foreign exchange through exports. Agriculture provides the economy with a large, though declining, source of employment. Finally, restructuring agriculture will free government resources for more appropriate uses elsewhere in the economy.

U.S. Assistance to the Agricultural Sector will:

- Reduce the cost of production through increased efficiencies.
- Focus on increasing the rate of privatization of land and implementing market driven pricing and investment promotion policies to stimulate private agribusiness expansion;
- Improve the institutional and infrastructure support services to agriculture; and
- Improve the delivery of credit to emerging private sector entrepreneurs.

B. ENERGY AND ENVIRONMENT

1. Energy

The Lithuanian energy sector is characterized by almost total dependence on imported oil, gas, and nuclear fuel from Russia; inefficient use of energy in industries and buildings; old and inefficient thermal power and district heating plants; and a large Chernobyl-design RBMK nuclear reactor, which is considered unsafe by many Western experts.

Shortages of fuel in 1992-93 resulted in severe cutbacks in heat to residential consumers and production curtailments in industry. Foreign exchange constraints severely limit Lithuania's ability to import needed energy, invest in rehabilitation of plants, explore for oil and gas, and modernize the large Mazeikiai refinery. Both the EBRD and the World Bank have provided funding for emergency energy imports. The Government substantially increased energy prices in 1992 and is developing an energy policy and sector restructuring strategy. The creation of a clear policy and institutional restructuring framework is critical to mobilizing foreign loans and private investment.

The World Bank and the Lithuanian government have prepared a

study on scenarios and options for the Ignalina power complex. This plant is a major source of export revenues and also provides 70-80% of Lithuania's domestic requirements. The bottom line is that the GOL is not in a position to close the plant in the near-term since it has neither the funds to build alternative nuclear facilities nor to finance imported fuel or electricity. It is therefore looking to upgrade the safety of the plant and is looking to Swedish, EC, and U.S. assistance in this process.

U.S. Assistance in Energy Will:

- Increase the safety of the Ignalina nuclear power plant and develop an effective, independent nuclear regulatory authority;
- Support improved energy efficiency;
- Promote power sector restructuring and modernization;
- Promote regional approaches and cooperation in addressing energy issues;

2. Environmental Protection

There is an urgent need in Lithuania to devise a coherent plan for protecting the environment while dealing concurrently with the transformation of the economy. Although trade-offs between economic development and environmental degradation are impossible to avoid in the short term, there remains considerable scope for coordination of reforms of basic economic institutions and reforms of environmental policy.

U.S. Assistance in Environmental Protection Will:

- * Strengthen the ability of the GOL to develop and implement environmental laws and regulations;
- Enhance knowledge of the interactions and trade-offs between economic development and environmental protection; and
- Promote sound environmental policy, waste minimization, and pollution prevention.

C. Strengthening Democratic Institutions

Political developments in Lithuania demonstrate that ideals of democracy are tested in the face of harsh economic realities. Accordingly, assistance which addresses the two previous strategic priorities will help foster an environment in which fragile democratic institutions can strengthen their footholds in Lithuania.

Democratic processes must be strengthened; this can only be accomplished by empowering the Lithuanian people through

education and by encouraging responsiveness and accountability in public officials. Many of the GOL officials and civil servants are holdovers from the nonresponsive and overcentralized Soviet system. Sustained efforts will be necessary to overcome the Soviet legacy, to encourage development of watchdog organizations and to develop public confidence in the system. Assistance should thus focus on promoting the political process, strengthening the foundations and institutions of a civil society, and public sector reform and development. Assistance will continue to involve ongoing and planned USIS activities in this area as well as A.I.D. grants to organizations specializing in democratic institutions.

In order to address needs in this area in a more coherent and coordinated manner, a democracy commission has been established. Chaired by the Ambassador and involving several country team members, the commission works to ensure that all activities in this area promote a common direction. The small grants program implemented through USIS has begun and targets local NGOs which otherwise might not receive USG assistance.

U.S. Assistance in Strengthening Democratic Institutions will:

- Promote the development of an independent and well-trained judiciary, including court restructuring;
- Strengthen the legal system by addressing issues involved in rule of law in a free and democratic society, including constitutional issues, civil service, government ethics, and legal structures to deal with organized crime;
- Promote political party development and the improved functioning of the legislative body of government;
- Assist local PVOs and NGOs to play an advocacy role for their constituents;
- Strengthen the role of an independent media in a free and democratic society;
- Promote and strengthen public administration, principally at the local level; and
- Promote civic education programs which explain roles and responsibilities of groups and individual citizens in a democratic society.

ANNEX I: POLITICAL SUMMARY

Lithuania became independent in 1991 after 45 years of Soviet occupation. The new Constitution, adopted by a popular referendum on October 25, 1992, provides for a popularly elected unicameral legislature, called the Seimas; a popularly elected President, who functions as Head of State with considerable powers in foreign and security affairs; and a parliamentary democracy form of government led by a Prime Minister and other ministers, appointed by the President and approved by the Seimas.

The Lithuanian Democratic Labor Party (LDLP) won a majority in the Seimas and the head of that party, Algirdas Brazauskas, was elected to the presidency by direct vote, winning more than 60% of the vote. Adolfas Slezevicius was then appointed Prime Minister. The LDLP announced as part of its platform that it would slow reforms. The fact that this has not happened is due to the role that the international lending institutions have played in supporting the reform process and the perception by the GOL that there is no alternative to the reform course established by the previous government.

Lithuania has generally been more successful in addressing minority issues than its Baltic neighbors. Lithuania's population is 80% ethnic Lithuanian, 9% Russian, and 7% Polish. Lithuania adopted a "zero-option" citizenship law on December 13, 1991, which extends citizenship to persons who were born in Lithuania; who were citizens prior to 1940, and to their descendants; and who became citizens prior to December 11, 1991. All applications for restoration and naturalization go through a citizenship committee appointed by the Seimas, which appears to have wide discretion. Qualification for naturalization requires a ten-year residency, permanent job or source of income, knowledge of the Constitution, and proficiency in Lithuanian. Over 90% of all Russians and Poles living in Lithuania have applied for and been granted citizenship.

The Lithuanian and Russian Defense Ministers signed an agreement on September 8, 1992 on the removal of Russian troops and on August 31, 1993 the last forces stationed by the former Soviet Union in Lithuania had been removed. Lithuania is pursuing an active policy of gradual integration into Western economic and security institutions. It is a member of the Council of Europe, and was one of the first countries of Eastern Europe to sign the Partners for Peace document. The Lithuanian leadership is on record as seeking NATO and European Union membership.

ANNEX II: ECONOMIC SUMMARY

Relative to 1992, in which GDP fell by almost 38 percent and inflation topped 1000 percent, 1993 was a year of relative economic improvement: real GDP contracted by only 16 percent and the rate of inflation slowed to about 190 percent. The industrial sector was still hard hit in 1993: industrial output fell by some 47 percent. Most of this decline was a result of the breakdown of the distorted system of production constructed under Soviet central planning. However, taking into account the growing, but largely unrecorded, private sector, overall output is judged to have shown stronger performance than recorded in official statistics.

Starting with the second half of 1993, real wages reversed their earlier declines and inflation moderated further. The recovery of the economy from mid-1993 was reflected in increased trade volumes as well. In 1992, imports had been constrained by a shortage of external financing. With access to financing, an increase in necessary imports resulted in a current account deficit of 6 percent of GDP (\$192 million). In volume terms, exports to and imports from the former Soviet Union (FSU) are estimated to have contracted by roughly 40 percent in 1993, while the corresponding growth estimates for the non-FSU area are 24 and 18 percent respectively. One reason for the continued deterioration of Lithuanian trade relations with Russia stems from the Russian imposition of extremely high tariffs against Lithuanian exports, sometimes at 200 percent of the value of the product. In addition, the Russian Parliament has not ratified MFN status for Lithuania. On the capital account side of the Balance of Payments, investment and official flows have resulted in a capital account surplus of \$313 million (up from \$195 million in 1992).

Because of the importance of energy imports relative to overall imports, increasing energy prices since the breakup of the Soviet Union have resulted in a continuing deterioration in the terms-of-trade. In 1993 it fell by 15 percent on top of a decline of 45 percent in 1992 for a total income loss of 20-25 percent of GDP. However, there are encouraging signs that the economy has become more energy efficient which is likely to improve the terms-of-trade situation in the future.

On April 1, 1994 the GOL implemented a currency board. Under this arrangement, the Lithuanian currency, the Litas, is 100 percent backed by foreign currency reserves and gold, and is tied to the U.S. dollar at a rate of four Litas to the dollar. This action is expected to have a stabilizing effect on the economy as inflation rates and interest rates begin to converge towards U.S. levels. However, tight liquidity in the financial sector keeps nominal interest rates around 100% annually. With the currency board, the investment risk associated with foreign exchange risk

will be virtually eliminated, thereby encouraging foreign investment.

Inflation fell to an average monthly rate of 4.75 percent in the second half of 1993. It is predicted that this rate will fall further with the institution of the currency board, and may fall to an annual rate of 50-60 percent for 1994. By mid-1993 nominal interest rates began to decline, though at a slower rate than inflation, yielding positive real interest rates. As a result, bank deposits grew rapidly and fueled a credit expansion in the second half of 1993.

The value added tax (VAT) went into effect on May 1, 1994 and replaced the cumbersome excise tax. However, problems with VAT administration and a recent increase in government pensions and wages of 10% are increasing pressure on the Ministry of Finance to raise more revenue. This occurs at a time when the GOL has a targeted budget deficit of nearly 7 percent of GDP.

Despite the fall in output, official employment levels have remained remarkably high. Although the scope for dismissals has been increased, firms have sought to rely on the use of unpaid leave and shorter working hours to minimize layoffs, and the decline in real wages (of 45 percent in 1993) has also significantly reduced the cost of labor and reduced the need to layoff workers. Although the GOL officially estimates unemployment to be only 2-4%, it is generally felt that this figure dramatically understates unemployment and fails to take into account severe underemployment.

Progress in implementing structural measures has been uneven but encouraging. Further reforms are anticipated in financial sector restructuring, privatization, enterprise reform, legal and institutional reform for commercial activity, competition policy and economic policy management. The authorities are amending the Central Bank Law and Commercial Bank Law, are reviewing bank licensing procedures, designing a plan to privatize the three big state banks, and are reviewing capital requirements. As for privatization, the GOL plans to allow for more diverse ownership by removing rules that gave preferential treatment to managers and employees. The establishment of hard budget constraints is a key component of the program and the GOL will strengthen bankruptcy legislation and its enforcement.

Increased private sector activity indicates that the economy probably has hit bottom and that conditions will progressively improve. The IMF has estimated that an increase in real GDP of almost 5 percent may be possible for 1994.

ANNEX III: STAFF PLAN
LITHUANIA

	FISCAL YEAR			
	94	95	96	97
USDH	2	2	2	2
USPSC (OE)	2	2	2	2
FSN:				
Professional	3	4	4	4
Support	5	6	6	6
TOTAL	12	14	14	14

ANNEX IV: DEMOCRACY STRATEGY

The thirst for sovereignty and independence motivated Lithuanians to lead the break up of the former Soviet Union. But having achieved these goals over a two-year struggle (1989-91), the new leadership was faced with making their new state function. A commitment to democracy and the free market were often stated as guiding principles. But in fact, Lithuanians had no experience with either. The leading pro-independence voices (Vytautas Landsbergis and others) defined their nation mainly as not-the-Soviet Union and aspired to recreate the now idealized interwar republic. They saw the West as their salvation, especially Western security structures which could protect them from Moscow. Their main opponents, most of whom served in the communist party and state structure in Soviet Lithuania, advocated gradualism and taking account of the interests of eastern neighbors while opening up to the West. In neither case, however, was there a very clear sense of what democracy meant at the participant level - the role of officials as servants of the people and the role of citizens as responsible players on behalf of themselves and the body politic.

The United States and other Western countries have tried to help in the development of democratic institutions in Lithuania, with some success. But there is much more that needs to be done, both at the official and the unofficial level. In particular, we need to remain engaged in strengthening the rule of law, public administration, the parliament, civilian control of the military and free media while becoming more involved with non-governmental organizations, with efforts to strengthen the social safety net, to enhance the role of women, to improve ethnic tolerance and to fight crime. The Embassy's democracy commission, under the Ambassador's leadership, will be our primary mechanism for establishing priorities, for overseeing implementation of all democracy related projects, for vetting new opportunities and for evaluating results. We particularly welcome the small grants program and have already identified several recipient organizations. It is a welcome new tool toward our goal of helping Lithuania to take its place in the community of democratic countries.

When Algirdas Brazauskas took office in February 1993, he made the point that he was first president in the history of Lithuania to be elected to that office. He also said that the transition was the first without bloodshed in Lithuania history. The elections which brought his Lithuanian Democratic Labor Party to majority status in the Parliament in October-November 1992, and himself to the president's chair in February 1993, were free and fair, with heavy voter turnout - nearly 80 percent. Through this exercise of their voting rights, as through their spontaneous participation in the independence struggle earlier, the people of Lithuania showed that they understood the power of political

participation. They also showed that those who led the independence struggle could not count on the automatic support of the electorate, and that pragmatic former communists may be preferable to ideological nationalists.

In the period since those elections, however, the level of political interest and activity among most people has fallen, partly because economic life has become harder and partly because habits of behavior have changed slowly. One commentator observed that the new Lithuanian state exists but has no citizens, in the sense of people who take part in public affairs or who accept public responsibility (a Soviet-era saying to explain why public facilities from toilets to parks are so poorly maintained is, "that which belongs to everyone belongs to no one"). This view is unfortunately too true. It is almost universal here to expect government - or government employees - to solve the problems of individuals, to right wrongs and to grant favors. Farmers, laborers, students, teachers, pensioners - all seek special treatment from the government rather than work to organize for self-help. But when the government cannot or does not produce effective remedies, the reason is assumed to be corruption and incompetence. As a result, trust in government has fallen, while apathy and cynicism have grown.

Yet the picture is not entirely bleak. Together with the burgeoning growth of private business activity has come the birth of several non-governmental organizations - business groups, women's groups, environmental activists, free trade unionists. The press is remarkably open (but not always responsible), cultural and artistic life is rich (but top artists are leaving for better pay in the West), and parliament functions as a forum for a wide range of diverse views (but majority and minority members are barely civil to each other).

The U.S. assistance program has from the beginning targeted democratic institution building as one of its priority areas. Among the projects in which we have invested time, money and effort, the main ones are:

- Rule of Law which includes assistance in drafting the Constitution and Constitutional Law; training and developing a more independent judiciary; strengthening the Office of the Procurator General;
- NDI/IRI activities include promoting the role of an independent media, political party organization and development, municipal development;
- Labor activities include support through the AFL/CIO's Free Trade Union Institute to promote independent union development;
- Frost Commission activities include parliamentary training and providing the computer hardware and software for enhanced information processing and access for the parliament;

- VOCA activities teach individual farmers how to form self-help cooperatives;
- Public administration - IESC and others;
- Peace Corps SEED.

The Military-to-Military program, implemented with National Guard and reserve personnel, stresses civilian control of the military and the rule of law, as well as other items.

Within these fields, however, the program content has changed as circumstances have changed. For example, the ABA-CEELI program devoted much effort to constitution making in the early months, and had a significant influence on the document which was passed in a national referendum in 1992. Now the Rule of Law program has moved on to focus on commercial law and judicial training - both major priorities, but different from those of 1992. Similarly, early projects on election procedures have given way to others on party building. And the very useful Frost Commission program with the Seimas (parliament), to upgrade information systems and staff training, will soon move on to a long-term bibliographic focus.

Other Western donors have helped in some of the same fields, but the effect has been to augment rather than dilute the benefits. For example, several of our NATO allies are helping Lithuania to prepare for its role in the partnership for peace, but none has a program like our Mil-to-Mil program. For another example, France and the U.K. have provided training for some government officials. But there are many more, especially at local levels, who need such training. For another example, the EU and Sweden have helped in some areas of legal reform. But these programs are complementary to ours, not contradictory. In these and other fields, we and other donors share information with each other and with the Lithuanian government to try to assure that our limited resources are wisely directed. The needs are great; there is enough work for all of us.

The Embassy's Democracy Commission held its first meeting on March 23. The meeting was chaired by the Ambassador and included the Economics Officer, the Political Officer, the PAO, the USAID Rep, and the Head of the Military Joint Contact Team as full members. Also participating were representatives of the Defence Attache's office, the Peace Corps, the SOROS Foundation and U.S. Baltic Foundation. The Ambassador reviewed the PRD-36 mandate to establish the Commission and noted the on-going USIA and USAID programs in this field. He designated the PAO as coordinator for the Commission, with close support from USAID. Each of the participants then reviewed activities in his/her area. From this review emerged suggestions to consider small grants in the following fields:

- To the Association of Independent Electronic Media to host a conference asap on the theme of the threats to, and strengths of, free media in Lithuania;

- To a new Institute of Human Rights which plans to work with Ministry of Culture and Education to implement the introduction of American-style civics into Lithuanian secondary schools by the beginning of the 1994 autumn school semester;

- To the Lithuanian Lawyers' Association to support the inauguration of a periodic newsletter;

- To support publication and translation of American texts in the fields of law, public administration and civics which cannot be immediately funded from USIA's initial book translation budget.

Other possibilities include projects in the following fields:

- Labor advocacy;

- Local government development;

- Commercial law development emphasizing contractual relationships among private entities.

The Commission agreed to look at all these proposals, most of which fit within our priority areas, and encouraged official and unofficial participants to provide further details and grant applications for deserving projects. The Commission will meet once per month to review those applications and to decide on specific grants.

APPR: CP ()
DRAFT: JK ()
CLEAR: PO ()
CLEAR: BDH ()
CLEAR: ()
CLEAR: ()
CLEAR: ()

UNCLASSIFIED

USAID/ENI/ECA/NT:JKARP
06/26/94 736-4077
USAID/ENI/DAA:CPASCUAL: STRATUPC.LIT

USAID/ENI/ECA:BDHOWARD (DRAFT)

PRIORITY VILNIUS

AIDAC TO USAID REP JOHN CLOUTIER AND COUNTRY TEAM

E.O. 12356: N/A

TAGS:

SUBJECT: REVIEW OF U.S. ASSISTANCE STRATEGY UPDATE FOR
LITHUANIA

JOINT STATE/USAID CABLE

THIS IS AN ACTION CABLE; SEE PARA 6.

1. SUMMARY. THE DRAFT UPDATE TO THE 1993-1995 SEED ACT ASSISTANCE STRATEGY FOR LITHUANIA WAS REVIEWED ON JUNE 7 AT AN INTER-AGENCY MEETING CHAIRED BY USAID/ENI BUREAU DEPUTY ASSISTANT ADMINISTRATOR, CARLOS PASCUAL. REPRESENTATIVES FROM USAID, STATE, TREASURY, USEPA, USIA, COMMERCE/CLDP, AND FTC ATTENDED. THE CONSENSUS OF THE MEETING WAS THAT THE STRATEGY FOR LITHUANIA CONSTITUTED A SOLID STATEMENT OF USG ASSISTANCE PRIORITIES AND DIRECTIONS, AND THAT SEED ACT ASSISTANCE SHOULD CONTINUE FOR THE NEXT SEVERAL YEARS. PARA 6 SUMMARIZES DECISIONS REACHED AND RECOMMENDATIONS IN SPECIFIC PROJECT AREAS. PARA 7 OUTLINES NEXT STEPS FOR USAID REP ON BEHALF OF COUNTRY TEAM. END SUMMARY.

2. GENERAL PROGRAM CONCLUSIONS. THE STRATEGY UPDATE PROPOSES A GREATER EMPHASIS IN ASSISTANCE TO

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AGRIBUSINESSES; INCREASE IN FUNDING TO ENVIRONMENT PROJECTS IN OUT YEARS; AND IMPROVED COORDINATION OF DEMOCRATIC PLURALISM INITIATIVES. THE GOVERNMENT OF LITHUANIA (GOL) WAS CONSULTED PRIOR TO SUBMISSION OF THE COUNTRY TEAM'S STRATEGY UPDATE AND CONCURS WITH THE SUBSTANCE OF THE STRATEGY AS SUBMITTED. PHASE OUT OF SEED ACT ASSISTANCE IS NOT PROJECTED PRIOR TO END OF THE DECADE, BUT THE USAID REP NOTED COUNTRY TEAM INTEREST IN WAYS TO CONSOLIDATE PROJECTS IN ORDER TO ACHIEVE GREATER PROGRAM IMPACT.

3. STATUS OF REFORMS. IT WAS AGREED THAT MAJOR U.S. ASSISTANCE OBJECTIVES IN LITHUANIA ARE STILL NOT FULLY MET, DUE TO A SLOWING OF GOVERNMENT REFORMS. WHILE THE DECLINE IN OUTPUT APPEARS TO HAVE REACHED BOTTOM LAST YEAR AND INFLATION HAS ABATED SINCE THE INSTITUTION OF A CURRENCY BOARD, A HALF CENTURY OF MISMANAGEMENT PERSISTS IN CREATING A CLIMATE ADVERSE TO ECONOMIC RESTRUCTURING. PROGRESS MAY THEREFORE BE UNDERMINED IF STRUCTURAL REFORMS DO NOT PICK UP SOON.

4. FUNDING LEVELS. APPROXIMATELY USD 13.0 MILLION ARE PLANNED FOR FY 95, INCLUDING PART-FUNDING FOR THE BALTIC-AMERICAN ENTERPRISE FUND. OBLIGATIONS SHOULD PEAK IN THIS YEAR WITH A GRADUAL DECREASE EXPECTED IN FYS 96-97.

5. PROGRAM MONITORING/PERSONNEL RESOURCES. LAST YEAR'S STRATEGY REVIEW CONCLUDED THAT A U.S. DIRECT-HIRE GENERAL DEVELOPMENT OFFICER WOULD BE ASSIGNED TO POST TO FACILITATE COMPLIANCE WITH MONITORING STANDARDS SET FORTH BY THE FY 1993 FOREIGN OPERATIONS APPROPRIATIONS ACT. A USDH HAS BEEN RECRUITED AND WILL BEGIN DUTIES IN JULY. ADEQUATE STAFFING FOR OAR/LITHUANIA IN FYS 95-97 WILL BE ASSURED BY TWO USDH, FOUR PROFESSIONAL FSNPSC, TWO USPSC, AND SIX SUPPORT STAFF FSNPSC. OFFICE WORKLOAD MAY INCLUDE SOME ESTONIA RESIDUAL ACTIVITIES AFTER CLOSURE OF USAID/TALLINN, DEPENDING ON FORTHCOMING ENI BUREAU REVIEW OF THIS MATTER.

6. SUMMARY OF MAJOR PROGRAMMATIC ISSUES:

A. PRIVATE SECTOR/FINANCIAL SECTOR LINKAGES: USAID REP EMPHASIZED THE NEED TO IDENTIFY POST-PRIVATIZATION OPTIONS RELEVANT TO LITHUANIA'S STATUS AS A LINK IN THE FORMER SOVIET UNION'S ECONOMIC SYSTEM. EXTENSIVE DEBATE FOCUSED ON USG EFFORTS TO PROVIDE INCREASED AND SOPHISTICATED ASSISTANCE TO THE FINANCIAL SECTOR AND NEWLY-PRIVATIZED ENTERPRISES. CONCERNS RAISED CENTERED ON DELAY IN PASSAGE OF COMMERCIAL BANKING LAW AND LACK OF A GOL STRATEGY FOR FURTHER REFORM OF THE FINANCIAL/BANKING SECTOR. ANOTHER

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CONCERN RAISED WAS WHETHER THE INTERNATIONAL FINANCIAL INSTITUTIONS COULD EFFECTIVELY PLAY A GREATER ROLE IN VIEW OF GOL'S APPARENT LACK OF POLITICAL WILL WITH REGARD TO FINANCIAL SECTOR AND POST-PRIVATIZATION ENTERPRISE REFORM. CURRENT FUNDING ALLOCATION FOR FY 95 IS USD 2 MILLION (180-0014), BUT IN ORDER TO UTILIZE EFFECTIVELY, AN EXAMINATION SHOULD PROCEED OVER THE NEXT SEVERAL MONTHS INTO PROGRESS IN FINANCIAL SECTOR AND PRIVATE ENTERPRISE REFORM AND HOW USAID-FUNDED TECHNICAL ASSISTANCE/POST-PRIVATIZATION OPPORTUNITIES CAN BEST BE APPLIED. ENI/PER/ER AND ENI/PER/EP DIVISIONS, IN COLLABORATION WITH OTHER USG AGENCIES, ARE TASKED WITH DEVELOPING, IN COOPERATION WITH THE OAR, THE TERMS OF REFERENCE FOR THIS EXAMINATION.

B. COMPETITION POLICY, LAWS AND REGS AND BUSINESS SERVICES: A BUREAU ECONOMIC RESTRUCTURING OFFICER NOTED THAT, ABSENT STRONG POLITICAL COMMITMENT AND CONSENSUS, COMMERCIAL LAW REFORM IS DIFFICULT TO ACHIEVE. AREAS WHICH HAVE BEEN IDENTIFIED AS PRIORITIES BY THE GOL -- WHICH CONFORM WITH THE PROGRAM'S STRATEGIC FOCUS -- INCLUDE BANK SUPERVISION, COLLATERAL LAW (SECURED LENDING), AND BANKRUPTCY. THESE PROGRAMS WILL BE IMPLEMENTED IN CLOSE COORDINATION WITH OTHER DONORS (ESPECIALLY THE WORLD BANK) AS WELL AS CLOSE COORDINATION WITH OTHER PROGRAM ELEMENTS IN ORDER TO BE EFFECTIVE.

C. HOUSING PRIVATIZATION: ALTHOUGH IT WAS AGREED THAT ASSISTANCE TO DEVELOP MORE EFFECTIVE CONDOMINIUM MANAGEMENT TECHNIQUES (INCLUDING MARKETABILITY OF HOUSING PROPERTIES) SUPPORTED STRATEGIC OBJECTIVES, THE USAID REP STRESSED THE IMPORTANCE OF INTEGRATING THIS ASSISTANCE INTO EXISTING PROJECT ACTIVITIES IN ORDER TO AVOID PROGRAM QUOTE SCATTERIZATION UNQUOTE. ENI/EEUD/UDH COMMENTED THAT PERHAPS USAID COULD COORDINATE WITH THE IBRD (AS IN THE CASE OF ALBANIA AND SLOVAKIA) OR WITH TREASURY ON HOME IMPROVEMENT LENDING PROGRAMS. IT WAS NOTED THAT DIVERSE ETHNIC REPRESENTATION SHOULD BE TAKEN INTO ACCOUNT WHEN CHOOSING POTENTIAL ASSISTANCE SITES. IN CONCLUSION, THE BUREAU ENDORSED A PILOT ACTIVITY IN PRIVATIZED HOUSING MAINTENANCE TO BE INITIATED IF REPEAT IF EXISTING PROJECT VEHICLES COULD BE IDENTIFIED.

D. AGRICULTURE. ENI/EEUD/ED/AG EXPLAINED THE BUREAU'S PROJECT ACTIVITIES IN RELATION TO THE STRATEGY. THE MAJOR NEW INITIATIVE IN AGRIBUSINESS INFRASTRUCTURE BUILDING WILL BE IMPLEMENTED BY LAND O' LAKES THROUGH DEVELOPMENT ASSISTANCE FUNDING. PROPOSED PROJECT ACTIVITIES IN HELPING TO TRANSFER LAND TITLES, ASSISTANCE TO STATE-OWNED (AGRICULTURAL) BANKS AND RURAL FINANCING THROUGH PRIVATE

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COMMERCIAL BANKS MAY BE CONSIDERED FOR FUTURE ASSISTANCE. IF A LAND MARKET CAN BE FORMED, INITIATED BY THE BREAK-UP OF STATE FARMS, SOME KIND OF PROJECT ACTIVITY MAY BE CONSIDERED.

E. ENERGY/NUCLEAR SAFETY. THE KEY ROLE OF ENERGY SECTOR PROGRAMS WAS DISCUSSED IN RELATION TO THE G-7 STRATEGY TO ACHIEVE EARLY SHUT-DOWN IN PART OR IN WHOLE OF THE IGNALINA NUCLEAR POWER PLANT. IN THIS CONTEXT IT WAS AGREED THAT US ENERGY SECTOR ASSISTANCE WOULD FOCUS ON IMPROVING ENERGY EFFICIENCY, RESTRUCTURING AND MANAGEMENT OF THE POWER SECTOR, AND OPERATIONAL AND REGULATORY NUCLEAR SAFETY ASSISTANCE THROUGH USDOE AND NRC. THE G-7 NUCLEAR SAFETY ACCOUNT AT THE EBRD (TO WHICH THE USG CONTRIBUTED) IS FUNDING A SAFETY ASSESSMENT AND REGULATORY REVIEW OF THE IGNALINA UNIT. THIS REVIEW MAY BE COMPLETED BY LATE 1995 AND HAVE MAJOR IMPLICATIONS FOR USG AND OTHER DONORS' ASSISTANCE PROGRAMS. ENI/EEUD/EI REPORTED THAT ALABAMA POWER HAS AGREED TO WORK WITH LITHUANIAN STATE POWER SYSTEM AND THE U.S. ENERGY ASSOCIATION UNDER THE UTILITY PARTNERSHIP PROGRAM. THESE AND OTHER BILATERAL PROGRAMS WILL BE LINKED WITH REGIONAL ACTIVITIES IN RESPONSE TO THE BALTIC ENERGY COUNCIL'S REQUEST FOR U.S. ASSISTANCE IN ASSESSING REGIONAL ELECTRIC POWER PRODUCTION AND TRANSMISSION OPTIONS. USAID IS ALSO COLLABORATING WITH THE WORLD BANK AND TDA IN THIS EFFORT.

F. ENVIRONMENTAL PROTECTION: HOPEFULLY, GOL COORDINATION WILL IMPROVE WHEN ITS ENVIRONMENTAL DEPARTMENT IS ELEVATED TO MINISTRY LEVEL IN JUNE 1994. A LONG-TERM SENIOR ENVIRONMENTAL POLICY ADVISOR WILL SOON BE ASSIGNED TO THE NEW MINISTRY; HOWEVER, ENI/EEUD/ENR NOTED THAT ANY LIKELY IMPACT WILL DEPEND ON GOL'S WILLINGNESS TO IMPLEMENT POLICY ADVICE AND REFORMS, AND TO TRANSFER AUTHORITY TO THE REGIONAL AND MUNICIPAL LEVELS. THEREFORE, AN EVALUATION OF THE ENVIRONMENTAL INITIATIVES PROJECT (180-0004) WAS CONSIDERED PREMATURE SINCE ACTIVITIES IN LITHUANIA ARE RELATIVELY NEW. ENI/EEUD/ENR ADDED THAT THE GOL IS INTERESTED IN ASSISTANCE TO ESTABLISH ITS NATIONAL ENVIRONMENTAL ACTION PLAN (NEAP).

G. DEMOCRATIC PLURALISM INITIATIVES/PUBLIC ADMINISTRATION: USIA CONFIRMED THAT, DUE TO A NEED TO CONSOLIDATE PROGRAM EFFORTS AND ACHIEVE GREATER IMPACT, ITS BOOKS FOR DEMOCRACY ACTIVITIES WILL BE DISCONTINUED IN COUNTRIES LACKING EDUCATIONAL REFORM PROJECTS. IT WAS NOTED THAT THESE ACTIVITIES HAVE ENJOYED A HIGH PROFILE AND BEEN WELL RECEIVED BY THE GOL. USAID REP RANKED TOP THREE PRIORITY ACTIVITIES AS FOLLOWS: MUNICIPAL LEVEL PUBLIC ADMINISTRATION; POLITICAL PARTY STRENGTHENING; AND

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STRENGTHENING THE INDEPENDENT MEDIA. ASSISTANCE TO TRADE UNIONS SHOULD GRADUALLY PHASE OUT. COORDINATION IN THE RULE OF LAW PROJECT IS PROBLEMATIC. THE ENI/DG REP WAS REQUESTED TO HELP FACILITATE A MORE DETAILED WORKPLAN TO HELP RESOLVE UNCERTAINTIES AS PRESENTED BY THE AMERICAN BAR ASSOCIATION'S CEELI PROGRAM. ALTHOUGH SUBJECT OF LAW ENFORCEMENT TRAINING WAS DISCUSSED, NO CONCLUSIONS FOR ASSISTANCE WERE REACHED.

H. URBAN SERVICE DELIVERY SYSTEMS. USAID REP WAS NOT IN FAVOR OF IMPLEMENTING A PROJECT OF THIS MAGNITUDE AT THIS TIME. THE REVIEW MEETING CONCLUDED THAT EXPANSION INTO THIS AREA WOULD BE BEYOND OUR MANAGEMENT AND FUNDING CAPACITY AND WILL NOT BE PURSUED.

I. HEALTH SECTOR ASSISTANCE. IN RESPONSE TO NEW CONGRESSIONAL LEGISLATION RECOMMENDING BALANCE BETWEEN HUMANITARIAN AND ECONOMIC RESTRUCTURING ASSISTANCE, USAID REP REITERATED COUNTRY TEAM'S DISCRETE HEALTH CARE ASSISTANCE PROVIDED TO DATE. ALTHOUGH HEALTH CONTINUES TO BE OF INTEREST TO GOL OFFICIALS, IT IS PLACED BELOW THE THREE PRIORITY AREAS CURRENTLY BEING ADDRESSED BY THE STRATEGY. USAID REP COMMENTED THAT ASSISTANCE IN THE HEALTH SECTOR COULD BE WARRANTED ONLY AT PROGRAM BUDGET LEVELS HIGHER THAN CURRENTLY PLANNED LEVELS. OAR/VILNIUS HAS SUBSEQUENTLY RECEIVED A LETTER FROM THE MINISTER OF HEALTH REQUESTING FURTHER CONSIDERATION OF HEALTH-RELATED ASSISTANCE. USAID REP EMPHASIZED THAT ANY ASSISTANCE SHOULD BE RELATED TO ECONOMIC RESTRUCTURING/PRIVATIZATION. IT WAS AGREED THAT WE SHOULD NOT INITIATE A NEW HEALTH INITIATIVE, BUT THE OPTION WAS LEFT OPEN TO EXPLORE TAPPING THE REGIONAL HEALTH FINANCING PROGRAM (UNDER PROJECT NO. 180-0038) TO SUPPORT ACTIVITIES THAT WOULD REINFORCE OUR PRIVATIZATION AND RESTRUCTURING EFFORTS.

J. MANAGEMENT TRAINING. THE STRATEGY FORESEES A NEED FOR INCREASED MANAGEMENT TRAINING/ECONOMICS EDUCATION ASSISTANCE (CURRENTLY BEING PROVIDED UNDER AN USIA SMALL GRANT), AND FUNDING HAS BEEN ALLOCATED FOR THIS PURPOSE. THEREFORE, IF THE TECHNICAL APPLICATION REVIEW IS FAVORABLE FOR A GRANT IN LITHUANIA, BUREAU SHOULD PROCEED WITH AWARD/IMPLEMENTATION WITH INPUT FROM USAID REP.

7. RATHER THAN SPEND ADDITIONAL TIME EDITING THE COUNTRY STRATEGY TO INCORPORATE THE ABOVE COMMENTS, THIS CABLE WILL BE ADDED TO THE COUNTRY STRATEGY WHEN IT IS REPRODUCED. ANY NECESSARY CHANGES IN THE BUDGET, HOWEVER, SHOULD BE MADE PRIOR TO REPRODUCING THE STRATEGY.

8. THIS CABLE HAS ALSO BEEN CLEARED WITH THE FOLLOWING

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ENI BUREAU OFFICES: ENI/DG/PSP (HYMAN), ENI/PD (MORGAN), ENI/PER/ER (SHAPIRO), ENI/EEUD/UDH (LOW), ENI/EEUD/EI (ICHORD), ENI/HR/TE (FRENCH), ENI/DG/RFG (KOSINSKI), ENI/ED/EF (BROOKS), AND ENI/EEUD/ENR (TARRANT); AND OFFICIALS OF OTHER USG AGENCIES AND DEPARTMENTS; STATE (JMENZIES, SMCGINNIS), TREASURY (PLOFTUS, TGALLAGHER), COMMERCE/CLDP (LWELLS, LFEATHERS), USIA (SROBINSON), USEPA (VSAULYS), AND FTC (KRICHARDS). YY

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